

# Moscow Financial Weekly

For the week ending August 1, 2003  
Treasury Attache's office, U.S. Embassy Moscow

## Highlights

- Interros to purchase OVK banking group

## Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.2995	-0.08	-4.67
Monetary Base*	R1164.8 bln	-1.09	23.88**
CPI	NA		8.7
International Reserves*	\$63.9 bln	0.16	33.96
RTS Index (end of week)	451.05	-2.09	25.62
Refinancing rate	18	0	-3

\*For week prior

\*\* % chg from the abnormally high seasonal level at the end of the year.

## Economic Developments

The **Purchasing Managers Index** published by Moscow Narodny Bank, which is viewed as an indicator of growth in industrial production, increased to 54.1 in July. This is the index's highest level since October of 2001. The indices for June and May were re-evaluated to 54 points from 54.1 and 53.8 points respectively. (A level higher than 50 points reflects economic growth.) The PMI index has increased in each of the past six months.

**Moody's** rating agency has announced the possibility of increasing Russia's sovereign rating to Ba1 in the fall, which would be one level lower than investment grade and would be fixed on the same level as Russia's Fitch rating. (Fitch increased its Russia rating in early May by two points.) According to Moody's, an increase is possible because of Russia's strong economic indicators and effective external debt management. However, ratings agencies have said recently that further upgrades would depend on further reforms, in particular, banking reform. For their part, the markets have already priced in an expected increase to investment grade by next spring at the latest.

	S&P	Moody's	Fitch
Investment Ratings	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
Speculative ratings	BB+	Ba1	<b>BB+*</b>
	<b>BB*</b>	<b>Ba2*</b>	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-

\*Russia's current rating

### **Banking sector**

On July 28, the **Interros** Holding company (which owns 75% of Rosbank) announced that it had signed an agreement with Aleksandr Smolensky's Financial-Industrial Federation to purchase the OVK banking group, the STB-Card processing center, Incakhran (one of Russia's largest cash collecting and handling companies), and a number of smaller firms. The OVK group was built on the ruins of SBS-Agro, one of the most notorious banks that failed in 1998. It consists of six banks with several hundred branches and offices (350 according to Interros, although just recently Smolensky's son, the Chairman of the OVK Board, stated that the group had 400 functioning branches and offices and another 200 that were temporarily closed down.) Interros had been negotiating with Smolensky regarding the purchase of the OVK group for several years, but the parties could not agree on a price. Finally they arrived at \$200 million. It has not been decided yet whether Rosbank and OVK will merge into one bank, or will remain separate entities within Interros, with one specializing in corporate business and the other in retail. Interros now has an excellent chance to become the second largest player in the lucrative segment of retail banking, after the restructuring of its new OVK business is complete. The deal will be a test case for the new CBR rules streamlining procedures for bank mergers and acquisitions.

On July 30, **Rosbank** received its first international syndicated interbank loan. The \$40-million loan is given for 1 year at LIBOR+3.5%. It was arranged by HSBC Bank in the capacity of Mandated Lead Arranger and Sole Bookrunner, and by Standard Bank (London) as co- Lead Arranger. Besides these banks, Russian Commercial Bank Ltd. (Zurich), Ost-West Handelsbank, CSFB, Kazkommertsbank, Union Bank of California, Europaisch-Iranische Handelsbank, Finansbank (Holland) and Parex Bank (Latvia) also participated in the syndicate. Rosbank said that the loan would be used for general corporate purposes.

On July 31 **Sberbank** Board Chairman and President Andrei Kazmin made public comments regarding the financial results of his bank for the first half of 2003, saying that "we have never shown such good results before." The ratio of working assets increased to 97%, and the share of expenses to revenues came to 57%. (The average corresponding

figure for European banks is 55%.) Sberbank's net profit calculated by RAS increased in H1 compared to the similar period in 2002 by 27%, to R21.6 billion. Capital as of July 1, 2003 went up to R134.9 billion from R104.6 billion a year earlier. Credit portfolio, as of July 1, 2003, amounted to R646.9 billion, of which R570.2 billion accounted for loans to legal entities. The sum of balances in household accounts at the end of H1 stood at R820.5 billion. Sberbank's share in the total for retail deposits in Russia's commercial banks, as of May 1, 2003, was 76.4% for ruble accounts and 46.9% for foreign currency accounts. (According to Goskomstat, Sberbank's share in the total for retail deposits, both ruble and foreign currency, shrank to 65.4% as of June 1, 2003, from 66.8% at the beginning of the year.) Kazmin also said that in H2 retail deposit rates would be adjusted to match the yields on main financial instruments. Government bonds, on which current yields are lower than deposit rates and well below inflation, are Sberbank's main assets.

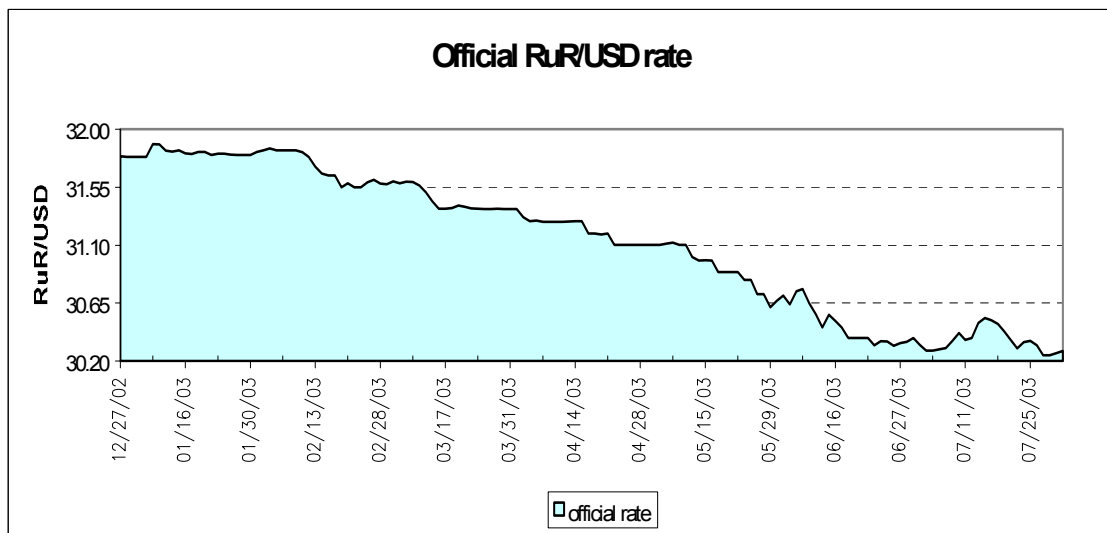
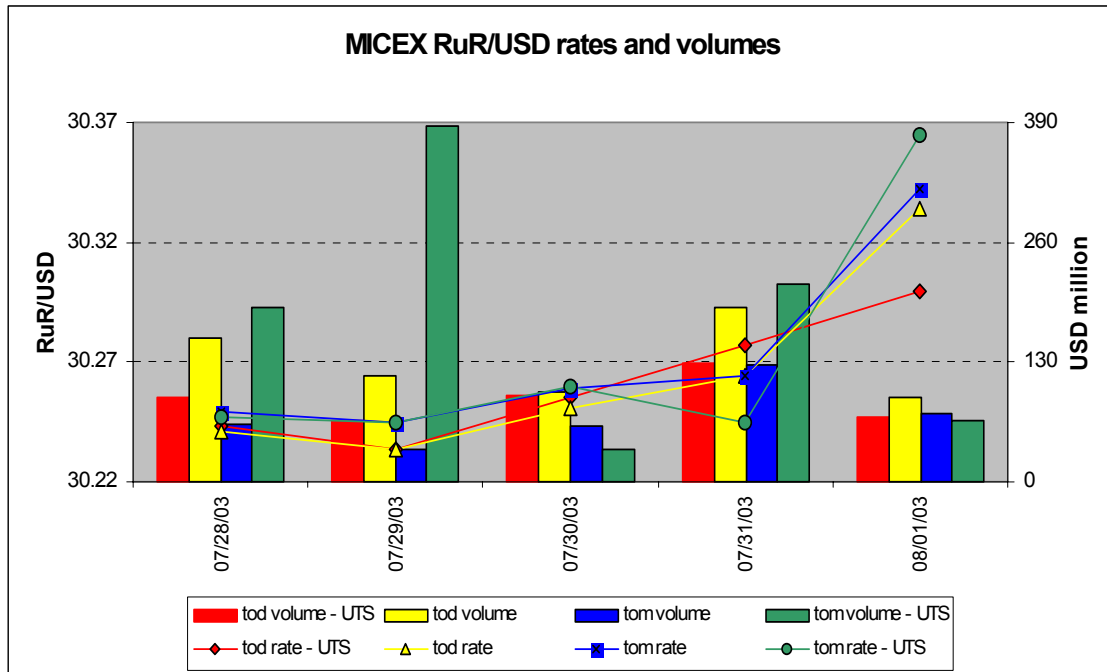
### **Financial markets**

#### **Forex Market**

The **ruble appreciated** in real terms against the dollar by 11.3% in the first half of 2003, according to the Ministry of Economic Development and Trade. The real effective (trade weighted) ruble rate went up over six months by 1.5%. The adverse impact of the ruble's firming on the competitiveness of Russian commodities is somewhat alleviated by the more favorable dynamics of the ruble/euro rate, MEDT comments: in H1 the real weakening of the ruble against the euro amounted to only 3.1%. The Eurozone accounts for about one-third of Russia's imports. MEDT forecasts that for the whole of 2003, the ruble will appreciate against the dollar by 12-13%, and by 4-5% in 2004. Real effective appreciation for the full year will be 4-5%, both in 2003 and 2004. The Ministry also lowered the average ruble/dollar rate forecasts for 2003 and 2004: from R33.7/\$ to R30.9/\$ and from R31.9/\$ to R31.3/\$, respectively.

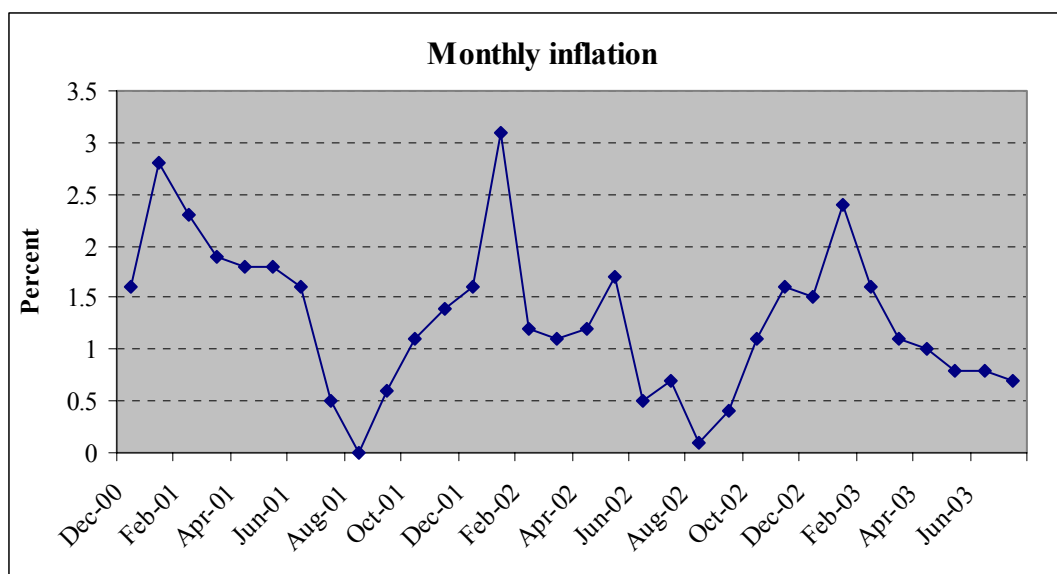
On Monday the dollar continued to fall against the ruble at a faster rate than on the previous Friday, driven by the worst end-of-month ruble liquidity strain in many months. This falling was stopped only by a CBR intervention at R30.2450/\$. On Tuesday, short-term loan rates increased even further, leaving the dollar under pressure, and the CBR continued intervening at the same level, to fix the UTS-tom average straight at R30.2450/\$. However, after that the situation with ruble liquidity turned back to normal and the dollar started growing against the ruble once again, this movement being bolstered by firming of the dollar on international forex markets.

For the week, the dollar weakened 0.08% against the ruble, closing in the UTS "tod" on Friday at R30.2995/\$. MICEX trade volumes were \$451.89 million and \$892.47 million, \$649.81 million and \$359.82 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.



## Prices

According to Goskomstat, inflation totaled 0.7% for the month of July. This represents a slowdown from the previous month, when inflation was 0.8%. Last month the driving factor of the inflation remained the same – service prices were up by 1.9%, while non-foodstuffs increased by 0.5% and foodstuffs – by 0.4%, excluding fruits and vegetables. Overall prices for foodstuffs rose by 0.7%. Inflation in Moscow was 0.4% for July (9.2% since the beginning of the year). Last year, inflation in July was 0.7% as well. The rate of price increases traditionally slows down during the summer months due to the drop in the prices of foodstuffs.



## Eurobonds

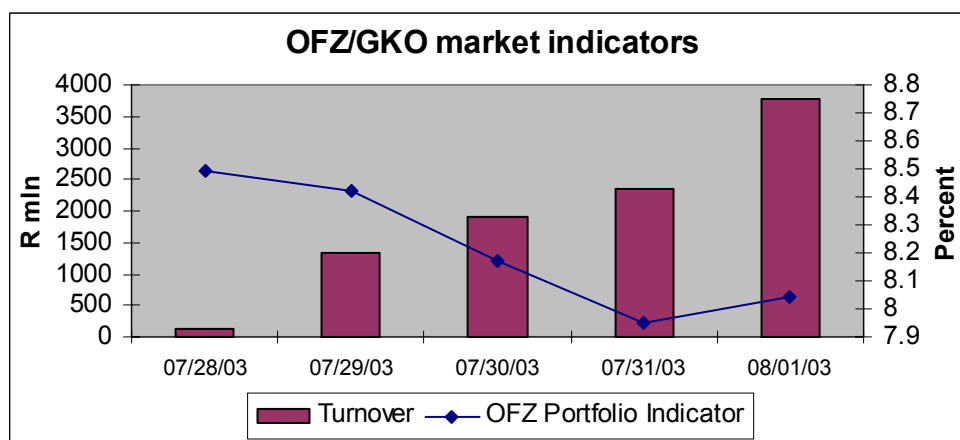
The Russian Eurobonds market was down again, with the negative trend accelerating by the end of the week. Again the main factor affecting the market was the U.S. Treasuries market, where yields were rising again. The positive news from Moody's at the beginning of the week helped the market slightly, but the continuing fall of Treasuries prices led to an overall downward trend.

## Interest/Bond Market

### *Bonds/Bills*

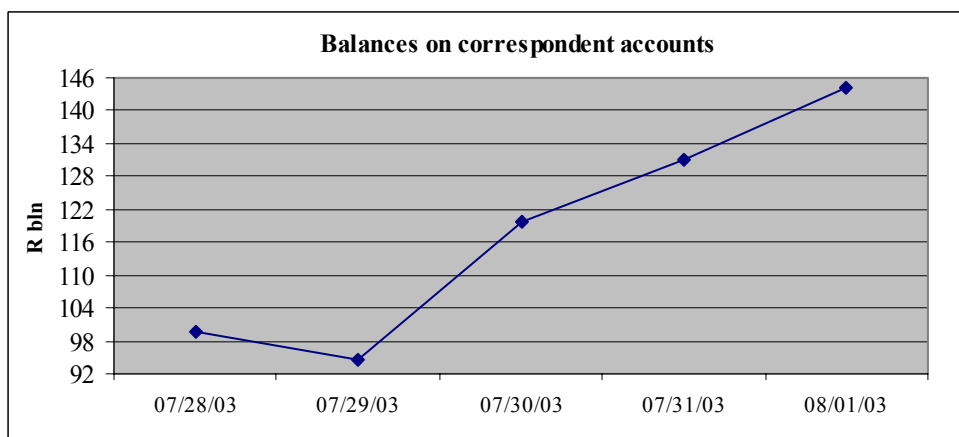
An increased in demand on the secondary OFZ/GKO market caused an upward spike in prices. However, the shortage of rubles in the beginning of the week didn't affect the

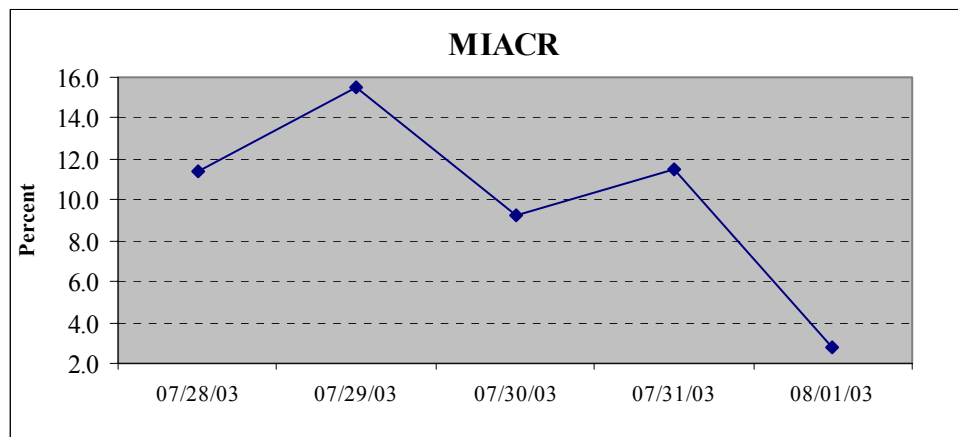
market at all – traders simply switched to CBR repo auctions to fill up with rubles rather than selling OFZs as before. Trading activity grew throughout the week, reaching R3.9 billion by Friday, which is quite a high level for the slow summer season. At the beginning of the week, prices of longer-term securities were rising, purchased by the large players. Closer to the end of the week, smaller investors stepped in, and the buying spread to the shorter-term paper.



### *Overnight rates*

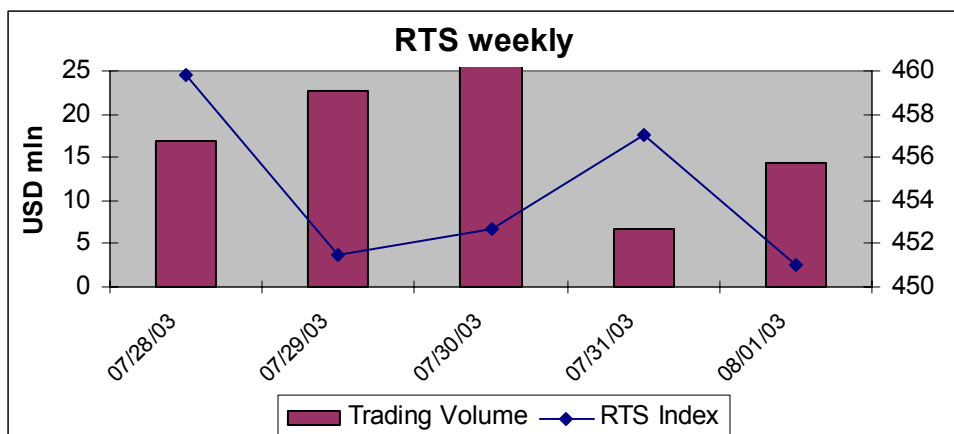
Balances on banks' correspondent accounts at the CBR fell last week due to the end-of-month factor (large obligatory tax payments). They hit a minimum of R94 billion on Tuesday – a level last seen at the end of April. The decreased ruble liquidity caused the rates on the interbank short-term ruble loan market to soar to 20-21% p.a. for overnights. Later in the week the situation got better, and the balances were back to levels which are common for the market these days.

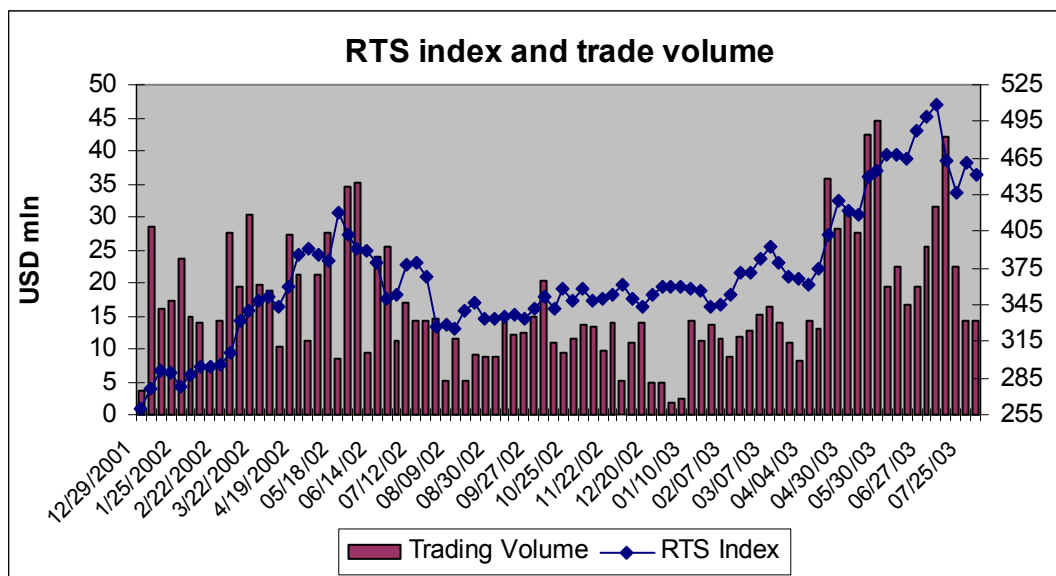
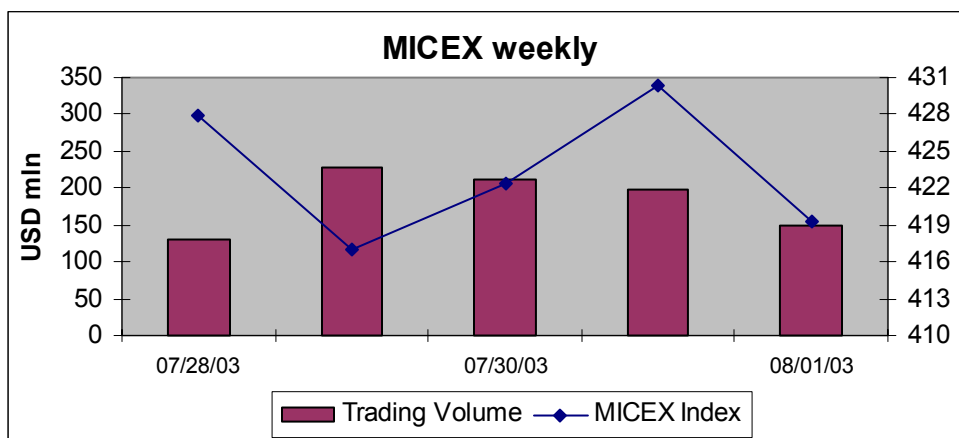




### Stock Market

The overall trend on the Russian stock market was negative last week. Trading activity was slow as is traditional during the vacation season in August. In the beginning of the week, news about the possibility of criminal cases against the management of Sibneft provoked a new wave of selling, which was exaggerated by the end-of-month shortage of rubles among the players. Sibneft was the main loser of the week – down by 12%. The leader of growth was Norilsk Nickel which was up by 3.5% for the week. These shares were doing quite well lately, mostly due to soaring nickel prices as a result of a strike at the Canadian company Inco, which caused a decrease in the supply of this metal. The RTS index was down by 2.09% for the week on decreased trade volumes.

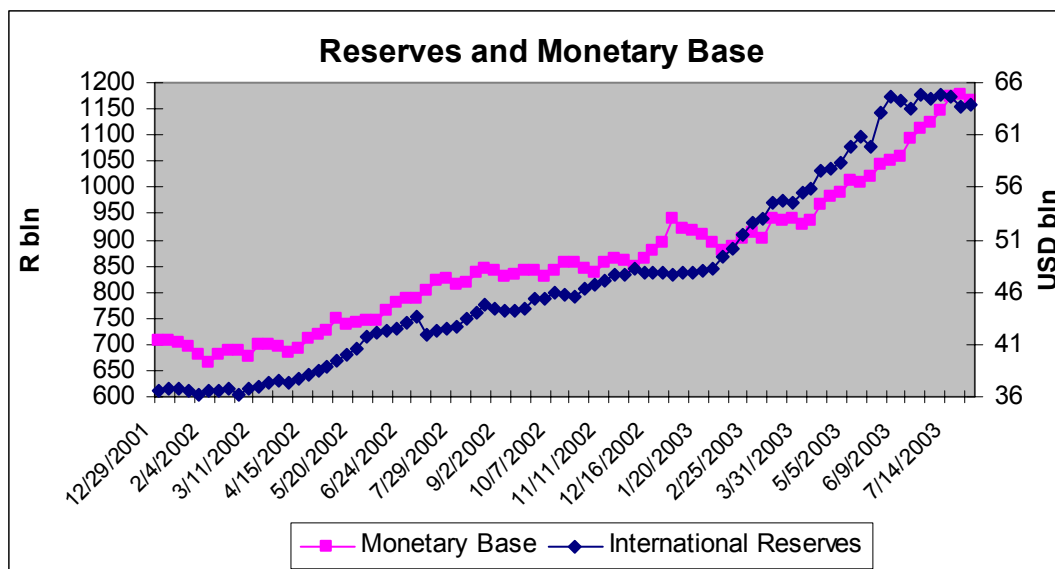




### International Reserves and Monetary Base

After falling for two weeks, the international reserves of the CBR increased by a modest \$100 million and totaled \$63.9 billion as of July 25.

After ten weeks of growth, the monetary base decreased last week by 1.09%, to a total of R1164.8 billion as of July 28.



## EXPLANATORY NOTES

**1. EXCHANGE RATES:** SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS "tom" weighted average as of 11:30 becomes the "official" exchange rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

**2. INTEREST RATES:** Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

**3. STOCK INDICES:** The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

**4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION** represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

**5. MONETARY BASE (M1)** is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

**6. LOMBARD CREDITS**, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.